

Experts View

Can an asset be objectively valued?

For some time here at Bestinver we have reiterated our conviction that the returns we have generated are predicated on the discrepancy between the price and intrinsic value of the assets in which we invest.

Those familiar with us know that we think that the school of economic thought that best reflects human condition is the Austrian School of Economics ⁽¹⁾. How, then, do we reconcile our price/value theory with the Austrian School observation that "prices are ultimately determined by value judgments of consumers" ⁽²⁾, i.e. their assessment of the value of an asset in this instance?

Is price the same as value or not? Here we attempt to clarify matters:

It is clearly logical to state that the price of an asset reflects the subjective judgments of the various persons active in the market for that asset. All accumulated and interpreted knowledge gathered by these agents is reflected "objectively" in the price formed. Naturally, this does not imply that all agents have the same level of knowledge or a similar interpretation, despite the fact that all this is input into price formation.

That said, our task is to uncover discrepancies between current prices, or more precisely, the prices that have just been formed in the recent past, and the valuations that the agents will determine for these assets in the future and which will, in turn, shape future price formation. In short, what we analyse are discrepancies between subjective current valuations and subjective future valuations.

To do so, we must factor in not only economic considerations, which are vital, but also other kinds of considerations, such as psychological, anthropological and sociological, to enable use to predict these changes in asset valuations. Here another factor perfectly explained by the Austrian School comes into play: the phenomenon by which businesses attempt to anticipate potential changes in human behaviour.

Many reasons can trigger changes in valuations, although they will not always do so. Therefore, we must focus on those for which we can estimate the change with the greatest probability.

Accordingly, a grounding in the Austrian School can help us to understand not only the credit bubble built up in Spain (via artificially low interest rates), but it can also teach us not to be naive and confuse value with price, as Antonio Machado would say.



(1) *The Austrian School of Economics was born from the work of Carl Menger, who gave continuity to a Continental tradition of economic thought which has its origins in the writings of the Late Scholastics at the University of Salamanca in Spain. Menger is considered one of the three fathers of Modern Economics thanks to the tremendous boost he provided to economic science by neatly resolving – based on the marginal valuations performed by individuals – the value paradox which so flummoxed the classical economists. The Austrian School is characterised for its a priori (deductive) approach and its tremendous realism. Among the school of thoughts most defining observations are the consideration that the individual is the protagonist of his actions and social processes and the notion that value is a subjective and individual phenomenon. This theory also places great emphasis on the concept of uncertainty, the subjective nature of information, competition as a process of rivalry in a free marketplace (no barriers to entry or exit for competitors) and cost as the valuation of the outcome given up by an individual when undertaking an action designed to satisfy another need (opportunity cost). In the field of political philosophy, the movement is characterised for its championing of individual liberties and private property. (My thanks to Gabriel Calzada for this explanatory note)*

(2) *Ludwig Von Mises (Human Action, Unión Editorial, Madrid 1995. pg. 400).*